

## ANALYSIS OF AMENDED BILL

Author: Granlund Analyst: Kristina North Bill Number: AB 1232  
Related Bills: See Legislative History Telephone: 845-6978 Amended Date: 01/06/98  
Attorney: Doug Bramhall Sponsor: \_\_\_\_\_

**SUBJECT:** Information Reporting/Discharge of Indebtedness

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

FURTHER AMENDMENTS NECESSARY.

☒ DEPARTMENT POSITION CHANGED TO **BOARD PENDING**.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED \_\_\_\_\_ STILL APPLIES.

☒ OTHER - See comments below.

### SUMMARY OF BILL

Under the Administration of Franchise and Income Tax Law (AFITL), this bill would allow a taxpayer who is not a financial entity and who discharges an indebtedness to file an information tax return with the Franchise Tax Board (FTB). This bill would require the FTB to process and record information contained in the information return.

### SUMMARY OF AMENDMENT

The January 6, 1998, amendment removed language to enact a jobs tax credit and added the language discussed in this analysis.

### EFFECTIVE DATE

This bill would apply to taxable or income years beginning on or after January 1, 1999.

### LEGISLATIVE HISTORY

AB 1218 (1997)

DEPARTMENTS THAT MAY BE AFFECTED:

\_\_\_\_ STATE MANDATE

\_\_\_\_ GOVERNOR'S APPOINTMENT

Department Director Position:

\_\_\_\_ S      \_\_\_\_ O  
\_\_\_\_ SA      \_\_\_\_ OUA  
\_\_\_\_ N      \_\_\_\_ NP  
\_\_\_\_ NA      \_\_\_\_ NAR  
\_\_\_\_ X PENDING

Agency Secretary Position:

\_\_\_\_ S      \_\_\_\_ O  
\_\_\_\_ SA      \_\_\_\_ OUA  
\_\_\_\_ N      \_\_\_\_ NP  
\_\_\_\_ NA      \_\_\_\_ NAR  
DEFER TO \_\_\_\_\_

**GOVERNOR'S OFFICE USE**

Position Approved \_\_\_\_\_  
Position Disapproved \_\_\_\_\_  
Position Noted \_\_\_\_\_

Department/Legislative Director      Date  
**Gerald H. Goldberg**      **3/1/98**

Agency Secretary      Date

By:      Date:

## **BACKGROUND**

The FTB receives, via magnetic media, copies of federal information returns reporting discharges of indebtedness filed by applicable financial entities with the Internal Revenue Service (IRS). The FTB does not currently have a state information return form or a process for capturing information return data not required by or provided on the federal information return.

## **SPECIFIC FINDINGS**

**Current federal tax law**, to which **state tax law** conforms, requires an applicable entity that discharges indebtedness (in excess of \$600) to file an information return with the IRS providing information including the debtor's name, address and taxpayer identification number, the date of discharge, and the amount of indebtedness discharged. An applicable entity means an executive, judicial or legislative agency or applicable financial entity (including banks, mutual savings banks, cooperative banks, domestic building and loan associations, savings and loan institutions, credit unions, the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the National Credit Union Administration and other specified federal executive agencies). Each entity required to make a return also must furnish each person for whom a return is made with the name and address of the entity required to make the return and the information reported on the return.

For the purpose of the information return, "indebtedness" means any amount owed to an applicable financial entity, including stated principal fees, stated interest, penalties, administrative costs and fines. If the obligation does not meet the definition of indebtedness, its discharge is not reportable as a discharge of indebtedness.

For **federal and state tax** purposes, gross income generally includes income realized from a cancellation of indebtedness (COD). Income is realized to the extent that a debt is canceled or forgiven. Included in the meaning of a debt is any indebtedness for which a taxpayer is liable or any debt that attaches to property held by the taxpayer. A restructured debt resulting in a reduction of the debt amount is considered a COD to the extent of the reduction.

**This bill** would allow a taxpayer who is not a financial entity who discharges an indebtedness to file an information return. **This bill** would require the FTB to process and record the information return.

## **Implementation Considerations**

As currently written, this bill relies on federal law for definitions of terms such as "indebtedness." All debts do not fall within this definition.

The author's office indicated that the intent of the bill is to allow a taxpayer who discharges any debt, such as unpaid rent, to file an information return reporting that action. However, rent is not "indebtedness" for tax purposes. Thus, the bill would not accomplish the author's intent. Instead, this bill, on a permissive basis, would extend to all taxpayers the requirement to report cancellation of indebtedness, such as a reduction in the amount owed on a mortgage.

Since there would be no federal reporting requirement, the department would have to create a separate information return to accommodate the information allowed under this bill and a process for capturing the information return data not currently required on the federal information return. Because information returns allowed by this bill would be handled manually, a delay in processing could result. Additionally, storage space would be required for the information returns.

## **FISCAL IMPACT**

### **Departmental Costs**

This bill would result in unknown departmental costs.

### **Tax Revenue Estimate**

Any tax revenue this bill may generate would depend on the extent to which taxes owed, due to discharges of indebtedness, would not have otherwise been assessed and collected. For this bill to generate a revenue gain would require the following circumstances: (1) a lender that voluntarily elects to report canceled debt; (2) a matching borrower that did not include the amount of canceled debt in gross income on a self-assessed basis; (3) the unreported canceled debt is undetected through other compliance activities, and (4) the department issues an assessment based on the voluntarily provided information return and eventually collects any assessed, additional tax. Any potential enhancements in revenue are speculative, but would likely be negligible. This enhanced revenue would only result for discharges of debts that meet the current law definition of "indebtedness."

The bill would be effective with income years beginning after December 31, 1998, with enactment assumed after June 30, 1998.

## **BOARD POSITION**

Pending.